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ONE HUNDRED TENTH CONGRESS

U.S. House of Representatives
Committee on Energy and Commerce
Washington, DC 20515-6115

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CHAIRMAN

April 17, 2008

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The Honorable John Dingell
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Committee on Energy and Commerce
U.S. House of Representatives
2125 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Bart Stupak
Chairman
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
U.S. House of Representatives
2125 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Dingell and Chairman Stupak:

A pair of news reports this past week in *The Wall Street Journal* indicates that a fast-growing, multi-billion dollar international carbon offset program may be producing little real gain in greenhouse gas reduction – a development of deep interest to the Energy and Commerce Committee as it deliberates over climate change policy.

According to the news reports (attached), the United Nations, which regulates the program, has started questioning the actions both of the developers of the offset projects and the auditors who inspect and certify the authenticity of the project gains. A number of projects have already come into question. Late last year, the project developer reportedly responsible for 10% of the market announced it would not deliver on one-quarter of its offset credits. Another major developer has filed for bankruptcy, as its offsets have come into question.

A key concern is carbon “offsets” that would have happened anyway are being sold as additional reductions, undercutting the whole point of the program. If this is the case, the only additional greening taking place may be in the bank accounts of the people selling these offsets.

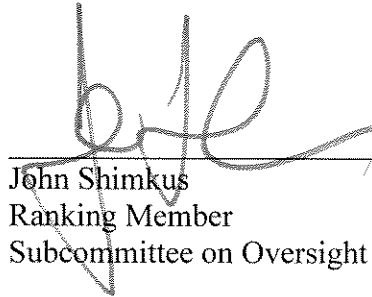
In light of these developments, which come on the heels of previous reports raising questions about carbon offset programs both domestically and abroad, we believe prompt and closer scrutiny by the Energy and Commerce Committee is warranted. We respectfully request that the Committee and the Subcommittee open an investigation and hold an investigational hearing on relevant aspects of carbon offset programs, focusing on the issues raised concerning the project developers, the auditors, and ability to regulate these marketing schemes, especially in connection with international agreements.

We would be happy to discuss our concerns and interests in a hearing with you directly. With all good wishes,

Sincerely,



Joe Barton
Ranking Member
Committee on Energy and Commerce



John Shimkus
Ranking Member
Subcommittee on Oversight and Investigations

Attachments

THE WALL STREET JOURNAL

U.N. Effort To Curtail Emissions In Turmoil

By Jeffrey Ball

1463 words

12 April 2008

The Wall Street Journal

A1

English

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A multibillion-dollar experiment designed to curb global warming is stumbling as regulators question whether the program is doing enough environmental good.

The United Nations is the main global policeman in an effort by wealthy nations to reduce the impact of their own pollution by paying for cleanups in the developing world. The program, known as the Clean Development Mechanism, is one of the most important coordinated efforts to attack global warming.

In recent months, however, U.N. regulators who administer the program have objected to dozens of these developing-world projects, ranging from hydroelectric plants to wind farms, questioning whether the projects would produce a real environmental payoff.

U.N. regulators are also concerned that some independent auditors of these projects, who are responsible for vetting their environmental legitimacy, have been letting project developers push through ventures of questionable environmental value.

The crackdown challenges a plank of the world's campaign against climate change: that polluters can pay someone else to clean up the mess. If the approach were to be discredited, curbing emissions could cost companies and consumers significantly more.

At issue, says Kai-Uwe Barani Schmidt, the U.N. panel's top administrator, is a conflict between "private-sector ambitions and the environmental integrity of the system."

As companies world-wide face government pressure to pollute less, the U.N. program gives them a cheaper alternative to cutting their own emissions. Instead, they can pay for the right to pollute by buying "carbon credits," essentially permission slips to spew carbon dioxide. Sale of the credits is supposed to help fund clean-air projects in China and other developing countries that would otherwise be too costly to build.

Last month, the panel declined to authorize the sale of carbon credits from two wind farms in the Indian state of Tamil Nadu. Backers of the projects, which have a combined 22 turbines, said their economic success depended on revenue from the sale of carbon credits. The U.N. panel said it wasn't persuaded.

The U.N. has rejected numerous other proposals on similar grounds since last summer. Among them: A Brazilian corn-processing factory, two Indian sugar mills and two Malaysian palm-oil plants. All were designed to install equipment to generate energy from renewable materials like wood scraps, fruit bunches and other waste. That would reduce the need for fossil fuels.

Developing-world projects like these are part of the burgeoning global carbon trade. In total, the global carbon market last year was worth 40.4 billion euros, according to Point Carbon, a Norway-based industry consultant. Of that total, Western companies and governments invested six billion euros last year in credits from projects in the developing world, nearly double the prior year, Point Carbon says.

In 2004 and 2005, as projects began to trickle in, the lightly staffed office of the U.N. Clean Development Mechanism's executive board approved virtually all of them. But as the number of proposed projects soared, the panel hired more staff and late last year tightened standards. In 2007, it rejected 9% of proposed projects, and held up another 21% for further review, according to U.N. figures -- many of which required changes before

getting the go-ahead. The U.N. demanded more financial data to prove many projects needed carbon-credit revenue to be feasible.

The U.N. says it isn't suggesting that most of the developing-world projects are illegitimate. Evaluating whether a project would have been built without carbon-credit revenue is a complex judgment call, says the U.N.'s Mr. Schmidt. It represents "one of the biggest challenges" of the current system.

The average developing-world carbon credit -- which grants permission to the buyer to emit a ton of carbon dioxide -- sells on the market for \$16 to \$24. The U.N. issued credits last year worth roughly \$1.2 billion to \$1.8 billion.

The carbon market was created by the Kyoto Protocol, a 1997 global treaty underlying environmental rules already in effect for much of the world and now being considered by the U.S. Congress. Most buyers of developing-world credits are in Japan and Europe. U.S. companies aren't buying them in significant numbers, market analysts say.

The U.N. regulators are questioning the actions of two main players in the carbon market: Project developers, who put together projects in order to sell the credits to Western industrial buyers; and the auditing firms that inspect and certify to the U.N. that the projects are environmentally legitimate.

A dozen or so project developers, most based in Europe, dominate the business. Among the largest is EcoSecurities Ltd. of Oxford, England. The U.N. has rejected several of its projects, often contending they would have been financially viable without the revenue from credits.

Bruce Usher, the New York-based chief executive of EcoSecurities, says the company's projects are environmentally legitimate. Last November, largely in response to the U.N. crackdown, EcoSecurities said it was writing off a chunk of the carbon credits it had promised the market it would deliver. Since then, the company's shares, traded on the London Stock Exchange's AIM index, have fallen 67%.

Three auditors dominate the business. All three -- Det Norske Veritas, based in Norway; Tuv Sud AG, based in Germany; and SGS Group, based in Switzerland -- are major European consulting firms for whom the carbon market is a small but growing franchise.

The auditors argue that they're not to blame for the questionable quality of some proposed projects. In a presentation to U.N. officials last fall, the head of Tuv Sud's carbon business told U.N. officials that the quality of projects the auditors are receiving from carbon brokers is "going down," according to the U.N. panel's Mr. Schmidt, who was at the meeting.

In an interview, the Tuv Sud executive, Werner Betzenbichler, declined to discuss his comments in the U.N. meeting. But he confirmed the substance of his presentation.

"There is a high incentive" for companies to put together environmentally questionable carbon-credit projects, "because there is a lot of money that can be earned," he said. "People are getting more inventive, so it's getting harder to detect the black sheep."

Luc Larmuseau, global director of climate-change services for DNV, echoed those thoughts. "We've seen some examples where we've got serious doubt," he says. DNV and the other auditors have prepared a dossier of their rejections and have sent it to U.N. regulators as part of their defense.

The issue came to a head in December, at a meeting between U.N. officials and auditors during a U.N. conference on climate-change policy in Bali, Indonesia. A member of the U.N. board, Christiana Figueres, expressed concern that the system may be open to what she called "collusion" between auditors and project developers to push through environmentally dubious projects.

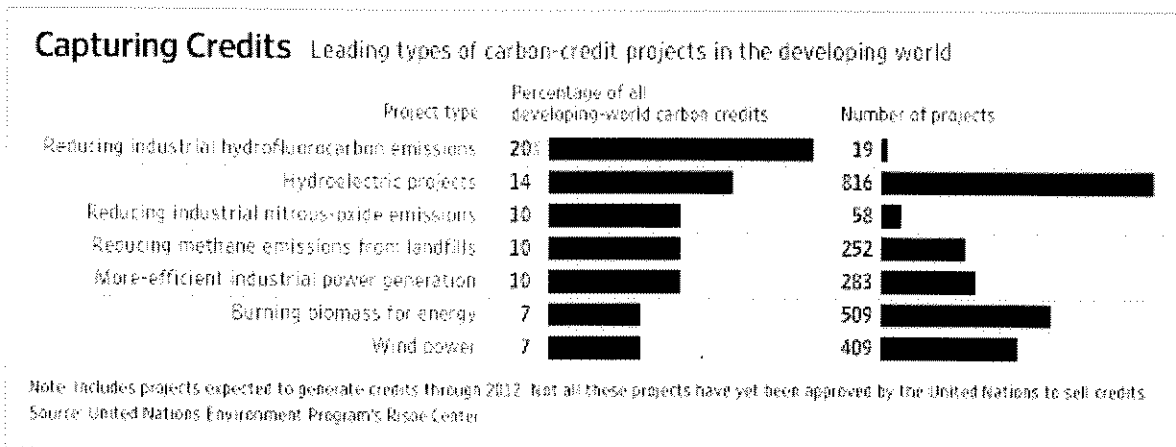
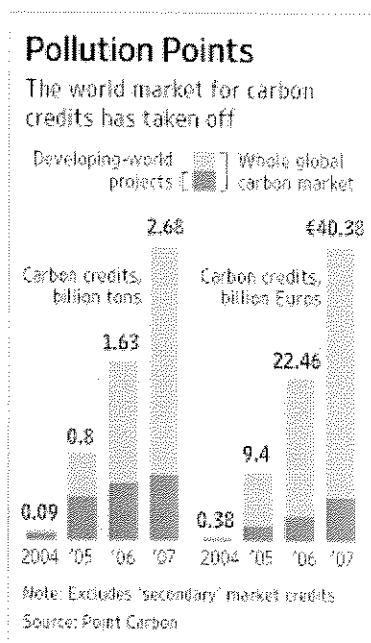
Ms. Figueres confirms that she used the term in the December meeting, but says she didn't intend to suggest that auditors are purposely recommending that the U.N. approve projects whose legitimacy the auditors doubt. Rather, she says, she was suggesting "a systemic collusion in which the [U.N.] board is being put in a position of having to do an in-depth review of these projects because [the auditors] are not doing it."

Ms. Figueres, a consultant living in Washington, D.C., left the U.N. board in January, when her term representing her native Costa Rica was up.

The U.N.'s Mr. Schmidt confirms that members of the U.N. panel "are aware of the clear and perceived risk of collusion" between auditors and companies putting together carbon-credit projects. One safeguard, he says, is the threat that the U.N. can revoke an auditor's accreditation if the U.N. finds that the auditor has done substandard work.

The auditors strongly deny they're acting improperly. In their defense, the major auditors, among them DNV, Tuv Sud and SGS, have produced statistics showing that they are rejecting significant numbers of projects before they're proposed to the U.N. Between the start of the market and the end of 2006, the auditors rejected 7.7% of the developing-world projects proposed to them, according to Robert Dornau, director of the climate-change program at SGS.

Deciding whether a proposed project needs carbon-credit money to be viable "is not black and white," Mr. Dornau says. Auditors are intent on showing they're fastidious because, he says, "we don't want to lose people's trust" in the carbon trade.



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THE WALL STREET JOURNAL

Up In Smoke: Two Carbon-Market Millionaires Take a Hit as U.N. Clamps Down --- EcoSecurities Sees Shares Slide 70%; 'In the Gray Zone'

By Jeffrey Ball

2317 words

14 April 2008

The Wall Street Journal

A1

English

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OXFORD, England -- Marc Stuart and Pedro Moura Costa have become multimillionaires in a booming new market designed to fight global warming.

Now, their empire is under attack.

Their firm, United Kingdom-based EcoSecurities Ltd., helps companies in the industrialized world meet their obligations to pollute less by selling them "credits" that fund clean-air projects in poorer nations. Last year, some \$9.4 billion in these credits were traded, up from almost none four years earlier.

The market's anything-goes early days now appear to be ending. United Nations officials who regulate the trade have started questioning scores of proposed projects, from hydroelectric plants in China to wind farms in India. The issue: whether they provide real environmental gains, or are just padding the pockets of middlemen like EcoSecurities.

EcoSecurities' woes are a prime example of how tough it is proving to be to launch a coordinated world-wide attack on global warming. The carbon-credit industry's growing pains come just as Congress is considering similar pollution-cutting rules targeting U.S. industries.

EcoSecurities is one of the main players in an international market that was created as part of the Kyoto Protocol to combat global warming. A key premise of the system is that, because greenhouse gases damage the atmosphere no matter where they originate, society should attack them first where the cleanup is cheapest, in the developing world. But policing that far-flung market has proved to be tricky because it involves valuing a commodity, climate-warming emissions of gas, that is far less tangible than oil or gold.

The "credits" sold by EcoSecurities and its rivals are supposed to fund clean-air projects in the developing world that otherwise wouldn't get built. But the U.N. is worried that players in the market may be gaming the system by putting a green imprimatur on some projects that would have happened anyway, defeating the intent of the U.N. program.

The tougher U.N. scrutiny is necessary to "ensure the environmental integrity of the system, because otherwise it's not achieving its purpose," says Kai-Uwe Barani Schmidt, the top administrator for the U.N. board that referees this trade.

EcoSecurities is one of the largest and most aggressive of a dozen or so major firms that scour the globe for projects like these, then profit by selling credits to help fund them. The main buyers are companies in Europe and Japan, whose governments have ratified the Kyoto Protocol, a global agreement imposing pollution caps on industrialized nations. Like EcoSecurities, most of the project developers are based in Europe.

That business is now in turmoil. Late last year, EcoSecurities said it would fail to deliver one-quarter of the credits it had promised. Its stock has fallen nearly 70% since that write-down -- and 80% since its peak last summer. The firm's two co-founders, Messrs. Stuart and Moura Costa, have lost about \$147 million on paper due to the stock's overall decline.

Mr. Stuart acknowledges that his firm, in its race to dominate the field, sometimes pushed the envelope. "The first

couple of years, this business was a land grab," he says. But many projects, he says, didn't generate as many credits as originally estimated, leading to last year's big write-down.

The firm's approach "was very successful at first, but it did leave a bit of a mess to clean up," says Mr. Stuart, a former Ultimate Frisbee champion at the University of Pennsylvania, who holds a master's degree in environmental law and economics from the London School of Economics. He is frank about the problems the industry faces.

"I guess in some ways it's akin to subprime," says Mr. Stuart, 43 years old, referring to the subprime-debt woes rattling the U.S. economy. "You keep layering on c--- until you say, 'We can't do this anymore.'"

EcoSecurities has helped assemble about 10% of all developing-world projects approved so far by the U.N., more than any other player. Its main rivals include Camco International Ltd., which says it, too, has had projects delayed. Another rival, AgCert International PLC, says the tightening of U.N. rules has contributed to the company's filing for protection from creditors in Ireland, its home country.

EcoSecurities is pushing back. It notes that the vast majority of its projects ultimately get approved. And it argues the U.N. crackdown hurts the environment more than it helps, since it delays clean-air projects and cuts off a funding source. It says regulators have failed to set clear rules -- and now they're changing their standards midstream.

One thorny issue: Who should vouch for the quality of clean-air projects? EcoSecurities says the U.N. scrutiny adds bureaucracy because it duplicates work already done by independent auditors who are hired to vet all projects. The U.N. panel should stick to an "executive and supervisory role," EcoSecurities says.

U.N. officials have questioned whether the auditors have been tough enough. The concern centers on whether auditors, who are hired by project developers, are adequately staffed to police the environmental legitimacy of the swelling number of projects. The auditors strenuously defend the quality of their oversight.

While that debate rages, EcoSecurities has been busy refocusing on projects less likely to raise red flags. For instance, it is shifting to projects to curb secondary greenhouse gases, such as nitrous oxide, produced in obscure industrial processes like nylon making. The problem, as EcoSecurities executives point out, is that targeting secondary gases does nothing to combat fossil-fuel use, which according to the U.N. is the primary man-made contributor to global warming.

The situation is "extraordinarily frustrating," Mr. Stuart says.

The trade in developing-world credits results from a provision of the Kyoto Protocol called the Clean Development Mechanism. A 10-member U.N. board vets proposed projects to ensure their environmental legitimacy. The independent auditors accredited by the U.N. act as the board's field inspectors, traveling the globe to certify whether a project is up to snuff.

Each credit is essentially a permission slip to emit one ton of carbon dioxide into the atmosphere. Currently these credits sell for \$16 to \$24 apiece.

EcoSecurities went public in late 2005 and was an immediate market darling. Mr. Moura Costa, 44, a Brazilian forestry expert living in Oxford, recalls that by early 2006 he was telling the firm's lawyers to ink contracts for new projects at the rate of one per working day. "It was a madhouse," he says.

Over the next 18 months, EcoSecurities contracted more than 200 additional projects around the world -- from Nicaragua to Inner Mongolia -- promising tens of millions of emission credits. Its stock price nearly tripled. Messrs. Stuart and Moura Costa became multimillionaires on paper.

EcoSecurities' rise coincided with a permissive U.N. board. In 2004 and 2005, the board automatically approved 95% of the projects proposed to it, according to U.N. statistics.

Mr. Schmidt of the U.N. says the board was thinly staffed at the time. By its current standards, he says, some proposals "probably went through without" proper scrutiny.

In mid-2006, there was an early hint that regulators were toughening their stance. The issue: manure.

Decomposing manure at farms emits methane, a greenhouse gas. The projects involve placing a tarp over the manure to capture and dispose of the rising gas. EcoSecurities expected at least 10% of its credits to come from projects like these.

But in 2006 the U.N. tightened its rules, requiring animal farms to measure the amount of methane they were capturing rather than simply estimating the number based on a formula -- and use the lower number. That move slashed by more than one-third the number of credits a typical animal-waste project would produce for sale.

Suddenly, the projects no longer made economic sense, Mr. Moura Costa says. EcoSecurities canceled most of them, erasing about \$100 million in potential profit.

Still, investors remained impressed with the company, because it continued to grow. Last July, with the stock near its peak, Mr. Stuart sold 2.2 million shares for about GBP 8 million, or about \$16 million, and Mr. Moura Costa sold 1.3 million shares for about GBP 5 million as part of a secondary offering, according to financial filings. The two men remain the biggest shareholders with a 20% stake between them.

Having money was a big change for the two men, Mr. Stuart says, recalling that when EcoSecurities was young he routinely charged up thousands of dollars of debt on his credit card to help keep it operating. After the stock sale, Mr. Stuart traded his 1994 Mercury Sable for a \$55,000 black Lexus hybrid sedan.

Around then, the U.N.'s crackdown started in earnest. The U.N. staff zeroed in on projects they had reason to believe might be financially viable even without revenue from the sale of credits. Last year, the U.N. board gave automatic approval to only 57% of proposed projects, down from 95% in 2004 and 2005. Overall, it rejected 9% of proposed projects last year, more than double its rejection rate in 2006.

One of the proposals blocked was an EcoSecurities project at a grain-processing plant in Uberlandia, Brazil, to replace oil-fired boilers with one using renewable energy like scrap wood. The U.N. said EcoSecurities hadn't proved that it needed revenue from selling credits to make economic sense.

EcoSecurities wasn't surprised the project got shot down: The company's own calculations showed that replacing the boilers made marginal economic sense even without the sale of credits.

The project "was in the gray zone" of the rules, Mr. Stuart says. He likens the U.N. panel to the Internal Revenue Service: "You push things as hard as you can, within what you think are reasonable guidelines. But every now and then the IRS will push you back."

The U.N.'s Mr. Schmidt says it doesn't surprise him that borderline projects like these get submitted. "If I were not to expect such behavior, I would be living in the wrong world," he says. Nevertheless, he says, "I don't see this particular case as trying to cheat."

Determining whether or not a project needs carbon-credit revenue is "a value judgment," he says. "It is one of the biggest challenges" of the carbon trade.

Mr. Schmidt, who has known Messrs. Stuart and Moura Costa for more than a decade, says he respects the company. "We have a very good relationship," he says. "We also know we have certain roles to play."

U.N. officials acknowledge that calculating whether a project can be economically viable without carbon-credit revenue is subjective. For instance, the calculus can swing widely based on whether oil prices surge, or fall. Similarly, it involves guesstimates of how long a project -- whether a hydroelectric generator or methane-recapture effort -- will remain operable.

EcoSecurities has more than 100 projects approved by the U.N., and only a handful rejected. But many of its proposed projects now are being held up by the U.N. for review. That's bad news for EcoSecurities because it delays its ability to start selling credits. The company originally operated on the assumption that U.N. approvals would take two months, on average. But now they're taking an average of nine months.

Starting last year, the regulators were "getting more and more obsessed with detail," raising questions that weren't relevant to projects' environmental integrity, Mr. Moura Costa recalls. He and other EcoSecurities executives expressed frustration to U.N. officials. The company's message, he says: "This is ridiculous."

Last fall, concern about the U.N.'s more activist role boiled over at EcoSecurities' headquarters here in Oxford. The

company uses a computer database it calls "Carbo" to monitor the rate at which its projects produce credits. As the U.N. clamped down, Carbo's "siren was going off," Mr. Stuart recalls.

In October, EcoSecurities executives gathered in the boardroom to confront a striking reality: In the space of months, the entire landscape of their industry had changed. Poring over their biggest projects, they debated how much of their business would need to be simply written off.

A big write-down "would have significant consequences to the company," Mr. Moura Costa recalls warning.

Ultimately, on Nov. 6, the company announced its write-off of 23% of the credits it had promised to deliver. Its stock fell 47% that day.

Since then, the stock has fallen further. It closed Friday on the London Stock Exchange's AIM at 84 pence, giving it a market capitalization of GBP 94.9 million.

Last month, EcoSecurities, which has 300 employees in 30 offices world-wide, reported a widened loss for last year of 45 million euros on revenue of 7.2 million euros.

EcoSecurities' largest shareholder, other than the two founders, is banking giant Credit Suisse, which bought an approximately 9% stake last summer when the stock was near its peak. Since then, Credit Suisse has lost two-thirds of its \$60 million investment.

"We don't believe the market is valuing the stock fairly," says Paul Ezekiel, who heads Credit Suisse's carbon business and who sits on EcoSecurities' board.

Given the lack of clarity in the U.N.'s rules, it's not fair to fault EcoSecurities for trying to maximize the number of credits it produces, he says. "It's like saying the speed limit's going to be between 50 and 90. So do you drive 55 or do you drive 85?"



Pedro Moura Costa

A Leader Stumbles

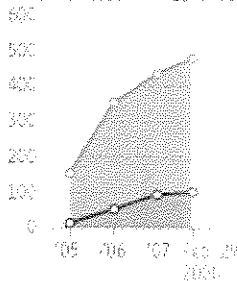
EcoSecurities raced to dominate the carbon-credit market. As U.N. scrutiny of the trade increased, its stock fell.

Note: £1 = \$0.5071 at the current rate.

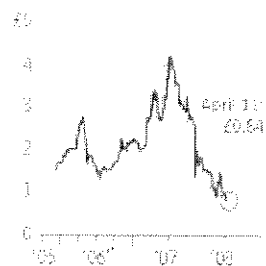
Sources: the company; United Nations; Thomson Datastream

Cumulative number of EcoSecurities credit-generating projects

— Contracted — Approved



EcoSecurities daily share price on the London Stock Exchange



Marc Stuart

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